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UNCLAS SECTION 01 OF 05 SHANGHAI 000187

SENSITIVE
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TREASURY FOR AMB. HOLMER, WRIGHT, TSMITH, AND OASIA - DOHNER,
HAARSAGER, CUSHMAN
USDOC FOR ITA MAC DAS KASOFF, MELCHER, MCQUEEN
NSC FOR WILDER AND TONG

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TAGS: [ECON](#) [PGOV](#) [ETRD](#) [EFIN](#) [KIPR](#) [ENRG](#) [SENV](#) [EWWT](#) [CH](#)
SUBJECT: SED ENVOY HOLMER VISITS SHANGHAI AND NINGBO

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11. (SBU) Summary. During a May 18-20 visit to Shanghai and Ningbo, Special Envoy for China and the Strategic Economic Dialogue (SED) Ambassador Alan Holmer, Managing Director for China and the SED Dan Wright, and Deputy Assistant Secretary for Transportation Policy Joel Szabat engaged U.S. business representatives, Shanghai academics and the national media on SED-related issues. Both academics and the U.S. business community were vocal in their support for a continuation of the SED dialogue in the next administration. The delegation also met with China Customs officials and Yangshan Free Trade Zone Administrative Committee representatives to discuss implementation of SED-related Customs agreements, IPR protection and other transportation and port-related issues. While visiting Ningbo, the delegation toured a newly-established wetlands area, discussed local trade issues with Ningbo Foreign Affairs officials, and engaged an official from Yinzhou Bank, a small, agriculture-focused bank, on its efforts to serve farmers and SMEs. End summary.

AmCham Shanghai: Hopeful for Continuation of SED

12. (SBU) In a roundtable discussion with 18 members of the U.S. business community, Ambassador Holmer briefed the group on U.S. disaster relief assistance in Sichuan Province and discussed SED progress and opportunities for progress. Business representatives were positive about the results of the SED and queried whether the SED would continue with the next administration. AIG General Insurance Company China Limited Assistant Vice President Eric Zheng attributed AIG's success in obtaining a business license approval to the SED and said his company had now established a wholly-owned foreign subsidiary in Shanghai. AIG is now "testing" the waters further by applying for three branch offices simultaneously. Javelin Investments Chairman and CEO Kim Woodard urged the SED to push for greater transparency on merger and acquisition rules for both sides. He opined the borders between "national economic security" and old-fashioned protectionism were increasingly blurring in China.

13. (SBU) Davis Wright and Tremaine Partner Ron Cai pointed out that there is unequal treatment for trucking license approvals, particularly in transporting HAZMATs and argued the issue should be addressed in the SED. In response to Ambassador Holmer's query regarding the impact of the RMB appreciation, Better Asian

Sources Chief Representative Daniel Krassenstein said the RMB appreciation, inflation, and increased labor costs have driven up the cost of export goods to the United States by as much as 20 percent, which U.S. consumers are not willing to accept. As a result, some Chinese vendors have begun substituting materials in products, which creates safety concerns in some cases. He added that there is a great deal of confusion in China over safety standards because there are different standards between the United States and E.U. and even within the United States. Krassenstein urged the United States to work more closely with the E.U. to develop consistent and unified safety requirements for Chinese goods. Tyson Foods China Director James Rice added that the United States should be more actively engaged in general with China in setting standards, rather than allow the E.U. or Japan to gain the advantage.

IPR Is Still An Issue

14. (SBU) Cai expressed that protection of intellectual property rights (IPR) is a real concern for companies who have environmentally-friendly technology that could assist China. As a result companies are not exporting their newest and latest energy efficient and environmentally-friendly technology to China. Rouse and Co. International Senior Consultant Diana Matthias said more rights holders are resorting to litigation to protect their IPR since the courts in the major cities such as Shanghai and Beijing are becoming more reliable. The problem is finding a viable entity against which to litigate. Matthias added that most counterfeits are not originating out of the ports in Shanghai or Ningbo because these port are more thorough in their screening. Most of the counterfeits are originating in smaller ports with less vigorous checks, and Customs in larger ports such as Shanghai does not recheck the goods. She also offered that many Chinese pirated goods are being shipped via Vietnam and Thailand.

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More Work Need on Environment and Energy

15. (SBU) Business representatives also asked if there have been any tangible results on energy and environmental issues as a result of the SED and whether the Olympics has moved these issues into the Chinese mainstream thinking. Ambassador Holmer replied that the Chinese are taking these issues with great seriousness and that in addressing these issues in the SED we are "pushing on an open door." Wright also enumerated the 10-year framework and five goals agreed to in the SED, which are established to address these issues. Squire Sanders Counsel and AmCham Environmental Committee Co-Chair Charles McElwee noted there is a vacuum of Chinese standards on the environmental side. In particular there are no standards on green products. He also urged a liberalization of investment regulations in these critical areas.

Brainstorm - An Opportunity for Public Outreach

16. (SBU) During a two hour media event on "Brainstorm," a popular, Shanghai talk show reminiscent of "Crossfire," Ambassador Holmer responded to remarks and questions from a four-member panel of experts, a large studio audience and the talk show host. The program, which will air on Channel Business News Asia, a partner of CNBC, will reach no less than 100 million viewers not only in East China but also throughout East Asia and in the United States. Ambassador Holmer began the program by reiterating U.S. condolences with respect to the three-day mourning period for the May 12 Sichuan earthquake. He then discussed his role as the Special Envoy for China and the SED, noting he was both an envoy to the Chinese Government as well as to the Chinese people. He also emphasized the strategic

nature and long-term approach to resolving issues in the SED. Panelists, the talk show host, and audience members raised a wide-range of questions ranging from the state of the U.S. economy to prospects for changes in U.S./China trade relations.

Shanghai Customs: Working on Implementing SED Agreements

17. (SBU) The delegation also traveled to Shanghai's Yangshan Deepwater Port and met with China Customs Director General for Duty Collections Gao Rongkun (who traveled down from Beijing for the event), Shanghai Customs Deputy Director General Chen Xudong, and Director of Yangshan Port Customs Shao Xiaoping. Gao outlined the role of China Customs and noted efforts in cooperation with the United States such as efforts to stop shipments of IP infringing goods and illegally-logged lumber, sharing of trade statistics, and counter-terrorism efforts. Shao briefed the delegation on Yangshan Port operations, noting that the port is now in its third phase of development that will be completed by the end of 2008. It is expected that Yangshan will handle 15 million TEU by 2010 with a total of 26 deepwater berths. Currently 60 percent of the containers arrive by truck, with the remaining 40 percent arriving by water (only a tiny fraction are international transshipments). Shao estimated within a few years the three components will be roughly one third of the total. Shao noted that Shanghai Customs does not re-inspect containers that have been cleared by other Customs offices throughout China; it only checks to ensure the seals have not been tampered with. Yangshan is also making an effort to induce foreign manufactures to move to the surrounding free trade zone area as a means to increase usage of the port. In 2007, Shanghai Customs collected RMB 23.8 billion (about USD 3.4 billion), almost doubling over the RMB 12.6 billion (USD 1.8 billion) collected in 2006.

Achieving Results on IPR Efforts

18. (SBU) Regarding IPR issues, Shao emphasized that Shanghai Customs attaches great importance to the 2007 SED Custom-related agreement with the United States. In 2007, Shanghai Customs intercepted 29 cases of IP infringing goods, valued at RMB 16.62 million. As of May 1, 2008, Shanghai Customs has caught 23 cases of infringing goods, valued at RMB 4 million. Shao noted

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that these numbers are a great improvement from the first four years (1994-1998) Shanghai Customs began monitoring for IP-infringing goods during which only 26 cases were uncovered. Shanghai Customs uses a system of targeting high risk goods and exporters for special examination. Although some cases are initiated by the rights holders, the vast majority are ex officio. Customs regulations require that each IPR-related case be reported to Customs headquarters. Chen added that Customs maintains a "blacklist" of traders, many of whom are reported by the United States. Customs intensely scrutinizes these traders for infringing goods.

19. (SBU) Chen also said Customs has made significant progress over the past year on six Customs-related projects initiated under the SED; in particular he noted progress on the rules of origin. Currently 56 percent of China's exported goods are produced by foreign-invested companies, many of which are U.S. enterprises. China Customs is undertaking thorough study and research on the origin of goods so that both sides can make a correct and clear judgment of bilateral trade. The United States and China also need to set clear standards on the rules of origin so as to set a clear example for other countries. Chen also said that he was not clear which U.S. agency was charged with coordinating SED-related issues with China Customs and asked for assistance in clarifying this issue. Ambassador Holmer assured Chen that the United States is fully committed to ensuring it lives up to the Customs-related agreements made in the third round of the SED and promised to get back to Chen

regarding the coordinator for the U.S. side.

Financial Academics: Exchange Rates, Inflation and More

¶10. (SBU) In a roundtable meeting with Shanghai Institute of International Studies Vice President Chen Dongxiao, Shanghai Academy of Social Sciences Vice President Huang Renwei, Deputy Director of the Institute of World Economy Xu Mingqi, and Shanghai Stock Exchange Deputy Director James Liu, Ambassador Holmer discussed current economic trends in China and SED initiatives. Huang welcomed that SED energy and environment initiatives are based on a 10-year plan and hopes the SED would continue into the next administration. He also emphasized that the Chinese Government is particularly concerned about "hot money," and the Government is allowing fluctuations as a way to discourage these flows. Chen agreed that the Chinese Government is in a quandary about hot money and said that the United States should make a joint statement with China as a way to discourage speculative funds. In response to whether current financial issues in the United States had dampened China's appetite for financial liberalization, Chen replied it had not, but it had changed China's desire for new financial instruments. Liu opined that China needs a true futures market that allows businesses to bet on the direction of the RMB/dollar exchange rate. This would provide a more reliable indicator to the Government on the direction of market forces. Liu also averred that the pause in RMB appreciation of the RMB is a political decision to help keep speculators off-balance.

¶11. (SBU) Chen also hoped the SED would be used to address the dramatic depreciation of the U.S. dollar and noted the Chinese Government is looking to the U.S. side for assurance that the U.S. economy will not worsen. Regarding why the RMB had remained steady over the past month, Chen said some believe it is because of high Chinese inflation. He believes overall RMB appreciation this year may be as much as 10 percent; however, it will largely depend on whether the appreciation has a measurable effect on cooling down the economy. If it does not, the Chinese Government will not be enthusiastic about allowing the RMB to go higher. Chen also opined that the U.S. election is factoring into China's decision to pursue new initiatives or wait until the next administration. Regarding China's inflation, he believed that China's price controls will only postpone higher inflation until a later date. This will likely occur after the Olympics, which may also be the start of an economic slowdown because of changed investment expectations. Xu and Huang also expressed concern that 2009 could be difficult year economically for China, noting slowing growth in 2008 of Chinese corporate profits, slowing exports and lower growth, added to which is the effects of RMB appreciation and increased labor costs on inefficient small and medium Chinese enterprises with already slim profit margins. Xu wondered whether the RMB's exchange rate will begin to depreciate against the dollar in 2009 in

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light of those adverse trends.

Ningbo Wetlands: A Testament to Sustainable Development

¶12. (SBU) During a tour of the newly-established Ningbo-Cixi Wetland Project, Ningbo Municipal Development and Reform Commission Division Chief Li Zhibo explained the main reasons behind the project: develop the wetlands as a habitat for international migratory birds, help reduce land-based contamination of coastal waters, promote wetland conservation and research, and provide a center for conservation education. The City of Cixi received a grant of USD 5 million from the Global Environment Facility, through the World Bank, to finance a wastewater treatment plant in Cixi and develop the 43.5 square kilometer wetlands area at the base of the just opened Hangzhou Bay Sea Bridge. The wetlands include a reclaimed mudflat area created to provide a nesting site for migratory birds, an

inter-tidal marsh area, and a small offshore island. According to Li, the Ningbo-Cixi Wetlands is the largest man-made wetland project in China and one of the country's eight officially designated wetland sites. Since its inception in 2005, the project has had a great impact on the bird population; the number of species has increased from 45 to 120. Li also said he and other managers of the wetlands hope to link up with similar projects in the Chesapeake Bay area to share ideas. He also proudly pointed out that projects like this show that sustainable development is "not just a slogan" in China.

Ningbo FAO Director: "We Want More High Tech Trade"

¶13. (SBU) Ningbo Foreign Affairs Office Director Kong Weiwei briefed the delegation on Ningbo's economic growth and aspirations for being a trading center for high-tech equipment from the United States. Kong said that part of the bilateral trade imbalance could be addressed by the United States giving the "green light" to exports of technology and equipment that would help China increase energy efficiency and reduce pollution. He noted that currently Ningbo's own trade statistics show a great imbalance with USD 18 billion of imports and 36 billion in exports. Because Ningbo wants to be a center for high-tech imports, it is pursuing a sister city relationship with Atlanta. Kong added that the agreement has not been reached yet because of Atlanta's budget issues, which precluded Atlanta officials from traveling to Ningbo. He noted that Wuhan is also courting Atlanta for a sister city relationship, and he hopes that both Chinese cities would be successful. Ambassador Holmer emphasized that the United States is not restricting environmental and energy-related equipment and technology - rather, many U.S. companies are concerned about exporting due to IP protection concerns and many of the Chinese tariffs on such goods are prohibitively high.

Yinzhou Bank - A Model of Rural Finance

¶14. (SBU) In Ningbo, the delegation also met with Yinzhou Agriculture Cooperation Bank President Zhou Jianbin to discuss local economic conditions and rural finance. Zhou described his bank as one of the first agriculture-focused banks in China serving farmers and SMEs. Although small in size with total deposits totaling around RMB 24.8 billion, the bank offers a wide variety of services ranging from credit cards to intermediary services. At the behest of the National Development and Reform Commission, Yinzhou Bank has set up branches in small villages and begun extending micro loans to farmers. Zhou emphasized that Yinzhou Bank also attaches great importance to corporate social responsibility, citing the bank's RMB 20 million donation to an underprivileged children's fund.

¶15. (SBU) Regarding growth risks from high inflation, global economic weakness, and RMB appreciation, Zhou maintained that China's strong organic growth is still intact. He said the past 30 year's strong output growth was driven by the economic development from coastal regions, such as Yangtze Delta Region, Pearl River Delta Region and Bohai Delta Region. Economic development in the middle and west part of China lagged coastal regions. If the pace of economic development in these two regions will pick up, 30 years of GDP growth shall be

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contributed from each, hence China still has 60 years of GDP growth ahead, Zhou reasoned. Zhou believes the RMB appreciation will gradually slow down and the RMB will even depreciate against the U.S. dollar in the future. He said that Yinzhou Bank had been marginally affected by the sub-prime credit crisis in the United States and added that the global credit crunch was felt most deeply by the China's four state-owned commercial banks. Although there has been an overall tightening of liquidity, Yinzhou Bank has actually been able to issue more loans to enterprises as the larger banks contracted their loan

portfolios.

¶16. (SBU) Ambassador Holmer has cleared this cable.
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